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How Philanthropy's Bad Habits Shortchange America

Thomas J. Tierney

William E. Simon Lecture

Annually, since 2007, the Manhattan Institute has sponsored the William E. Simon lecture on philanthropy and social entrepreneurship. This lecture series seeks to provide a framework—historical and current, scholarly and personal—for understanding the traditions and trends in American charity and charitable enterprises. Our first three lectures have ranged widely across these fields, including the 2007 talk by a distinguished historian, the 2008 talk by a renowned public policy essayist, and the 2009 lecture by the founder of the nation's most prominent management consulting firm for nonprofits.

THOMAS J. TIERNEY & HOWARD HUSOCK

Thomas J. Tierney is chairman and cofounder of the Bridgespan Group, an independent, nonprofit organization designed to provide professional services to philanthropists, foundations, and other nonprofits. From 1992 to 2000, he was chief executive of Bain & Company. In 2003, he led the development of Bridgestar, an initiative of the Bridgespan Group dedicated to enhancing and increasing leadership talent for the nonprofit sector.

Tierney joined Bain & Company in 1980 following graduation from Harvard Business School, where he received his MBA with distinction. A native of California, he received his BA in economics with highest distinction from the University of California at Davis, where he was honored as that year's most outstanding graduate. He served as a field engineer for Bechtel International in North Africa before entering business school.

Howard Husock is vice president for policy research at the Manhattan Institute and director of its Social Entrepreneurship Initiative. He was formerly the director of case studies in public policy and management at Harvard University's Kennedy School of Government.

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How Philanthropy's Bad Habits Shortchange America

Howard Husock: Good evening. Anytime those with an interest in management generally, or nonprofit management specifically, gather, it is appropriate to cite the work of Peter Drucker, widely considered "the father of modern management." It is especially so this year, the hundredth anniversary of his birth, celebrated last month around the world. It was Drucker who may have been the last consultant to put General Motors on a path to prosperity—that was back in 1946, when he published his book *Concept of the Corporation*, based on the two years he spent examining GM. It was around the same time that he began to address, with his customary insight and originality, the topic of nonprofits and philanthropy in America.

In 1990, Drucker wrote: "Forty years ago, when I first began to work with nonprofit institutions, they were generally seen as marginal to an American society dominated by government and big business, respectively. Today, we know better. Today, we know that the nonprofit institutions are central to American society and are indeed its most distinguishing feature." But Drucker was no cheerleader. He cautioned that "nonprofits need to learn to use management as their tool lest they be overwhelmed by it. They need management so that they can concentrate on their mission." Yet, he added crucially in his 1990 classic *Managing the Nonprofit Organization: Practices and Principles*, "little that is so far available to the nonprofit institutions to help them with their leadership and management has been specifically designed for them. Most of it was originally developed for the needs of business. Little of it pays attention to the distinct characteristics of nonprofits or to their specific central needs; to their mission, which distinguishes them so sharply from business and government; to what are 'results' in nonprofit work; to the strategies required to market their services and obtain the money they need to do their job."

Few people in American life have done more to rectify the problems that Peter Drucker identified than our speaker tonight. Tom Tierney, too, pursued a career focused on the for-profit world, serving from 1992 to 2000 as chief executive officer of Bain & Company, which he joined in 1980 after graduating from Harvard Business School. But like Drucker, he understood the extent and importance of America's nonprofit sector, and he set out to create an organization that could provide advice about strategy and leadership matters to nonprofits and the foundations that fund them. This consulting organization would fill the need that Drucker had identified and address the special challenges of nonprofit management and philanthropy.

While he was at the top of his game, Tom changed roles, spinning off from Bain the Bridgespan Group, the Boston-based nonprofit organization that he now leads. Its founding was a reflection of his understanding that a sector so central to American life, a sector including everything from the Red Cross to Habitat for Humanity to Harvard University, cannot thrive as the poor cousin of for-profit firms, with their fundamentally different missions and ways of measuring success. The nonprofit needs its own infrastructure of support and methods for identifying and nurturing talent. Bridgespan—along with its companion leadership and "job board" organization, Bridgestar—is providing just those things for many of the nation's most important nonprofits, particularly for young organizations that it considers especially promising.

Tom Tierney, not unlike Peter Drucker, has emerged as a practitioner/intellectual for the nonprofit world. His articles have appeared in the *Harvard Business Review*, the *Stanford Social Innovation Review*, *Philanthropy Magazine*, and elsewhere. You can find a number of his papers linked to the Manhattan Institute social entrepreneurship web page. He has reflected on how nonprofits can set practical goals and measure meaningful results. His topic tonight is how "higher-impact philanthropy" can identify and reinforce the good habits of successful nonprofits and avoid squandering the hopes of the millions of generous Americans who donate to charitable organizations every year. He has thought carefully about the two elements on which every Simon lecturer is asked to focus: social entrepreneurship and philanthropy.

Ladies and gentlemen, please join me in welcoming the 2009 Simon lecturer, Thomas J. Tierney.

Thomas J. Tierney: Thank you, Howard. I should begin by calibrating Howard's introduction a bit. People like Peter Drucker have influenced many of us in this room. I'm no Peter Drucker; I read Peter Drucker. I aspire to serve as best as I can with the gifts that I have been given.

When my cofounder, Jeff Bradach, and I launched Bridgespan in 2000, I stepped down from Bain & Company, an organization of about 2,000 people in twenty-plus countries, to become a full-time volunteer at a charity made up of four people in one cubicle. But I had a title—chairman—and Jeff and I had one objective: to help nonprofit organizations deliver breakthrough results. In the social sector, it's all about impact. And that's true at Bridgespan: we are a nonprofit organization, so our goal is not growth (though we have certainly grown) but to have an impact.

We launched Bridgespan almost ten years ago, and we have had a wonderful decade. When you launch a new venture, sometimes you think that you know more than you actually know. For example, we did not fully realize the power of combining business ideas with nonprofit-sector realities. We have made many mistakes, but we have learned a lot. We have had the privilege of working with hundreds of nonprofit organizations and dozens of great philanthropists. We have developed many ideas and worked with other thought leaders in the sector. And, it turns out, we are bridging not just the business and the nonprofit world, which was our original intent, but also the donors and organizations that they support.

I'm going to discuss what we're learning about delivering impact from the donor's perspective. Delivering impact is difficult, and the difficulty has nothing to do with the motivations of donors. On the contrary: foundations and private philanthropists want do the right thing; people don't want to waste their money. In fact, I think we'd all characterize philanthropy as an extraordinary American virtue. Voluntary action for the public good is deeply seated in our national culture and has its roots in the founding of our country as well as in the great religions of the world. But this passion, this mission to use one's own resources to serve others, is not only philanthropic. It's much broader than that.

After ten years as chairman of Bridgespan, I believe that philanthropy shortchanges America. Let me explain what I mean by that deliberately provocative statement.

In 2008, Americans gave over $300 billion to nonprofit organizations. I'm going to focus on the 10 or 15 percent of that amount that came from high-net-worth individuals and their charitable vehicles, including donor-advised funds and individual foundations. High-net-worth philanthropy tends to be higher-profile and involves bigger bets. People are using not just money but also influence and relationships—their personal brand—to drive impact. So is America getting its money's worth for this philanthropy?

When I started in the consulting business many decades ago, our efforts at marketing were, relatively speaking, very unsophisticated. At the time, we knew that half of the money we spent on marketing was wasted. We just didn't know which half it was. This happens sometimes in philanthropy, too: we know that half of the money being spent, granted, or donated is not generating results. We're just not quite sure which half.

This can be explained by two sets of root causes. One set I'll call "terrible truths." Those are the harsh realities of how the social sector works. Any philanthropist looking to deliver impact has to be aware of these truths. Not much can be done about them except to understand them, prepare for them, and deal with them.

The second set I'll call "bad habits." Think about these as self-inflicted wounds that philanthropists do not have to be burdened by but often are.

Terrible truth number one is that philanthropy is deeply personal. Number two is that when it comes to philanthropy and the social sector, capital allocation is irrational. Number three is that, in philanthropy, excellence is self-imposed. Now I will discuss each of these three "terrible truths."

Philanthropic gifts are propelled by all kinds of motives. I went to the University of California, Davis. I was happy to get into Davis, and was even happier to get out of Davis. After trying to study chemistry and almost flunking out, I did really well in tractor driving. Davis is an agricultural school, and, although agriculture is not my expertise, I feel a loyalty to the school. I don't hold Davis accountable for my own poor performance. So when I'm asked to donate money to the school, I do.

That's a familiar motive, isn't it? Here's another: I'm on the board of a nonprofit that is doing a capital campaign, and the chair of the campaign rings me up and asks me to do my share. I do my share. We all do our share and sometimes more than our share.

Some people enjoy recognition. Why do buildings have names on them? There's a philanthropic motive there. There's nothing wrong with that; we behave philanthropically for all sorts of reasons that are not necessarily tracked to the social impact generated by every single dollar. Not long ago, I was talking to a very wealthy man, whom I'll call Mike, who is setting up a $1 billion foundation. I asked Mike, "What are you trying to accomplish?" He said, "Honestly?" I said, "Honestly. What's your score card ten years out?" He replied, "I want to bring my family together." He went on to talk about how his kids were estranged, how he'd been working his tail off, and how he hoped that the foundation would bring his family together. I can think of a solution that wouldn't cost $1 billion, but this illustrates my point: philanthropy is not clinical; it's deeply personal. Sometimes it can be messy. And it wasn't just messy for Mike: Mike's wife had her own ideas, and his kids had their own ideas; even the family lawyer had ideas. They all had ideas about what this foundation was going to do, how it was going to do it, and what success might look like.

So philanthropy is personal, which makes it messy. Now for the second terrible truth: in financial markets, seed capital is the riskiest kind of capital. If you're financing something new, you demand a higher return because the probability of success is lower than it is with an established project. As you get to the second or third round of capital, when someone is scaling something that's well proven, the returns go down because the risk is going down. Growth capital is cheaper than seed capital; money follows success. But does this hold true for the social sector? If we have a proven nonprofit organization that has shown real results, does capital flow toward it? Do philanthropists reflexively say, "There's something that works here. Let's double-down on it?" Of course they don't—because philanthropy is personal.

Here's another billionaire story: this man, whom I'll call Fred, wants to fund his foundation to deal with K–12 education issues. I asked Fred, "How are you thinking about this?" Fred replied, "I'm just going to do lots of work on this problem." For decades, education nonprofits have focused heavily on K–12 issues. Fred is a full-time CEO and has not thought about K–12 until recently. "I've read what's out there," he told me. "I've talked to a few people. They don't know anything. I think I can figure this out." So Fred decided to do his own thing and start up yet another nonprofit.

On one level, this is good, because there is always room for new ideas. But where is the growth capital? Nonprofit capital markets are not rational. Philanthropic money, much less government funding, does not follow success. It follows other things. When you're trying to scale something that works, the capacity to deliver results is not something you can count on.

This brings me to terrible truth number three: excellence is self-imposed. This might be the most fundamental truth. Once you recognize it, you say, "Of course!" But when you come from business, you don't recognize it right away. At least, I didn't.

The power of the marketplace is phenomenal. When the Gap places purple sweaters on a shelf at its store in Boston's Copley Plaza in the morning, it knows exactly how many were sold by the end of the day. Last Friday's retail sales—down to the penny—are known within twenty-four hours. If you wanted to break that down by store and by purple sweater, you could because those data exist—we know exactly what's going on. Marketplaces tell you what to do. If your parts aren't selling, you change your products. If your business isn't working, you change your business or else you're toast.

Remember New Coke? They invested in years of consultants, focus groups, and market tests, and then they said, "Here's New Coke. We're putting it out there." What did the market say? In the social sector, New Coke would still be on the shelves. People would be saying, "You know, we really like this product." The philanthropist who funded it would be taking credit for New Coke, and the people who received the funding would be saying, "Keep that funding coming because people are really loving that New Coke." There's no marketplace to direct you. In the absence of that direction, you can make mistakes. And because there are no direct competitors or paying customers, there are no consequences for mediocre performance. You don't see executives or staff at philanthropies being fired because the impact was a "D-minus" instead of an "A." It's a cross between the Galápagos Islands and Lake Wobegon. In the Galápagos Islands, there are no predators. In Lake Wobegon, all the kids are above average.

You may not believe this next story, but it's true. At a board meeting of a foundation—it was a very sophisticated board—I started talking about its portfolio of grants. "So tell me about your bottom quartile," I said. One person said, "We really don't have a bottom quartile." I took enough math to know that there is almost certainly a bottom quartile. But in the absence of a marketplace, you begin to feel that there is no bottom quartile. And the kind of feedback that you get only makes the problem worse: How often, after all, do you hear people to whom you've given money say that you made a mistake in giving it to them?

So excellence is self-imposed. If you want to deliver impact, you have to decide that you want to do it. It's like exercise, or reading, or keeping your mind sharp: no one is going to make you do it, and no external forces will embarrass you or force you to do it.

As a businessman, I know that there are many terrible truths in business, too. You have to deal with tough customers, tough competitors, disruptive technologies, and so on. But there's a difference: in business, if you don't confront these terrible truths and deal with them, a Darwinian survival of the fittest takes hold and you're out of the gene pool. In the social sector—philanthropy, in particular—you can behave as if the terrible truths don't exist. The problem is that if you don't confront these truths, you will fail to deliver the impact that you deserve. That's why philanthropists intent on delivering results do confront the truths and don't make the mistake of underestimating how hard it is to give money in ways that make an impact.

What about those self-inflicted wounds, the bad habits that handicap us and allow a bad situation to become worse? Is it possible to overcome them? Absolutely.

Bad habit number one is what I call "fuzzy-headedness." One example comes from the practice of not asking the simple question, What's an "A-plus?" It's the question that I asked Mike. What's your philanthropic bull's-eye? What is success? What are you trying to accomplish? The answer can't be, "saving the world," "ending poverty," or "stopping global warming." What are you going to hold yourself accountable for? It's a powerful question. It is different from asking, What are you going to do? Without clarity about your goal, everything else falls apart.

A classic *New Yorker* cartoon captures the wishful thinking that is another form of fuzzy-headedness. It features a professor standing in front of a blackboard covered with algorithms and equations. Another man is sitting there, watching him work. The professor points to the blackboard and says, "And a miracle occurs here." So much philanthropy requires a miracle. For example, a company that I'll call the Great Plains Land Trust was going to start a capital campaign to save the grasslands. I asked, "What percentage of the grasslands is currently protected?" They replied, "Two percent." Then I asked, "What is the goal?" They replied, "Ten percent."

"Terrific," I say. "If you realize your wildest dreams with this capital campaign, how far will you get? What percentage of the grasslands will you be able to protect?" They replied, "Well, 2.2 percent." Now I was confused. "How do we get from 2.2 percent to 10 percent?" "Well, people are going to follow us," they said. "People are going to see the momentum, and are going to put in more money and buy buffalo and other things." "Okay. Who are these people?," I wanted to know. "We're not sure," they say. "Maybe people who care about the grasslands?"

All you have to do is probe a bit, and you find that a great many nonprofit organizations and philanthropists hold fast to the assumption that a miracle will occur. They are like the professor and his equation on the blackboard. The Land Trust people thought that they would get to 2.2 percent (they didn't, by the way) and then miraculous things would happen. It was just wishful thinking.

Bad habit number two is "flying solo." As I noted earlier, philanthropy is personal. It should come as no surprise, then, that philanthropists tend to want to do things their own way. One great irony of philanthropy, however, is that individuals actually accomplish very little by acting individually. Instead, you get things done by acting with and through others—other donors, grantees, partners, or government agencies. Often, we don't build on existing knowledge. Nor do we like to fund other people's deals. In philanthropy, collaboration often means that I put $1 million into your initiative, and later on, when I call you, you put $1 million into my initiative or my nonprofit organization. That's not collaboration; it's reciprocity. We aren't clear about what our role is in the ecosystem of other philanthropists, government agencies, or nonprofit organizations. Whether it's K–12 education or the environment, you're rarely going to solve a complex problem on your own.

Bad habit number three is underestimating and underinvesting. I'll bet that many of you have remodeled a kitchen, bathroom, or garage. And I'll bet that hardly any of you came in under budget and got it finished faster than you thought you would. Everything takes longer and costs more than you expect it will. The same thing happens here: philanthropists often vastly underestimate how much things actually cost, so they wrong-size their grants.

There's a pathology out there that exacerbates this. For example, say that I need $1 million for my nonprofit's after-school program. I've done the numbers, and it's going to cost $1 million. But I've never raised a million dollars, and it sounds like an amazing amount of money. So I say to myself, "It's not possible. Ask them for $500,000." I go to my donors, who say, "Gosh, that's kind of risky. Let's give him $100,000." I now have a $1 million initiative with $100,000 of funding. Do I hit it out of the park? Of course not. I do a so-so job. Then the donors say, "He's doing only a so-so job. We'd better not give him too much more money."

The result is a starvation cycle, where a problem that required a $1 million solution gets a $100,000 solution instead, and then it gets a $50,000 solution, and the problem persists. This happens all the time. The other part of the underinvestment problem is that funders are rarely willing to step up and say, "You know what? This is going to take $20 million, and it's going to take ten years. Let's not kid ourselves."

There's a flip side to this: how the money is directed. Some 80 percent of philanthropy goes to fund programs. That leaves 20 percent in unrestricted funding for the organizations themselves. Philanthropists, like most people, hate wasting money, and funding for overhead feels like a waste. Some organizations rate nonprofits on the amount of funding spent on overhead. Of course, less is assumed to be better. But is it? What are the implications of such an assumption? What if we all flew on airlines with the lowest maintenance costs? What if we all went to hospitals with the oldest, most fully depreciated equipment? What if we all sent our kids to the absolute cheapest schools, with broken-down buildings and teaching assistants, and no real teachers because they're more expensive?

There is, of course, bad overhead. Paying excessive rent is bad. But how about a chief operating officer? Or a chief financial officer who can do more than just keep the books? Is that a bad investment? In philanthropy, we often underinvest in basic capacity. We think that we can deliver A-level results with a C-level team. Boards of directors do this all the time. Imagine an outstanding chief executive who is growing a nonprofit organization. This CEO is fabulous at raising money but is burning out. And the board won't fund a chief operating officer because it's going to cost $120,000 a year, even though that's an input that will help the organization deliver the impact that society needs.

Bad habit number four is what I call "nonprofit neglect." Recently, I was talking to a large group of people who work at foundations. Someone suggested that foundations need to have conversations with their grantees about what works and what doesn't work in their relationships. Someone else said, "You know, we really just like talking to ourselves. We like talking to the people who have money."

A philanthropist is never better than the organizations and individuals he gives money to. Never. It is very easy to ignore this reality, but you can't give yourself an "A" for giving money to a team that scores a "C." If you're doing your own philanthropy, if you're investing, if *you* are the team, that's different. But the moment that you start giving money to other organizations, you'd better be sure that those organizations are capable of delivering the goods.

When Jim Collins wrote *Good to Great* and *Good to Great and the Social Sectors*, he used the phrase "Who's on the bus?" In my experience, nothing matters more than who is on your bus. Anyone who is in business knows how critical it is to have the right person in the right job at the right time. As businesspeople, we know it so well that we don't even have to think about it. But as philanthropists, we sometimes forget it. You're betting on people and on organizations. You have to do more than simply select the right people. You have to nurture the right relationships.

One of the most pervasive manifestations of nonprofit neglect is the hidden cost of capital, which comes in different forms. It's the philanthropist who thinks that he knows how to run after-school programs better than the people who have been doing it for twenty-five years, so he disrupts the strategy. It's the philanthropist who tries to change the behavior of the nonprofits that he gives money to. Of course, if you write a big enough check, you can do this sort of thing. But you're never better than the organizations you give money to, so you had better treat them accordingly.

Bad habit number five is chronic complacency. In the old days, some large corporations would contain a division that didn't seem very aggressive. That division would be content simply to make its numbers, to meet expectations. We called this "satisfactory underperformance." The division could have done a lot better but simply didn't. In philanthropy, there is a lot of satisfactory underperformance.

Complacency is telling yourself that you're doing just fine instead of asking how you can do a bit better. What's working? What isn't working? What is in the bottom quartile? If there isn't one, why isn't there one? What are other people doing that you could help with? What could you bring to the table besides money that might generate impact? Asking these kinds of questions takes time and work. It takes courage and a willingness to admit, "I'm not perfect. I have to learn. This is hard."

So philanthropy is shortchanging America. It's not intentional. But it is avoidable. You can be vigilant and disciplined about the terrible truths: the personal, messy nature of philanthropy; the irrationality of the capital markets; and the need to impose excellence on yourself. And you can avoid the bad habits that make those realities worse. It's hard, but it can be done.

Why does this matter? The downside of all this is that some 75 percent of America's foundations are created in perpetuity. If you can't overcome those terrible truths and if you start falling into those bad habits, you have mediocrity in perpetuity.

But the upside is that America has an unprecedented opportunity to dramatically increase the impact of its philanthropy in the next decade or two. Bridgespan has been working at this for ten years. One trend we've seen is philanthropists who impose higher levels of excellence on themselves and their grantees. There is a desire for results, a desire to know how we are doing and how we can do better. You see this from the Gates Foundation all the way down to individual donors. People want to achieve results with their money.

Living donors who are actively engaged in their philanthropy have a greater desire to achieve results because it's their money. Some living donors are stepping forward—some in their forties, some in their seventies—and saying, "I want my money to have an impact. I want results." It's a powerful trend that wasn't nearly as pronounced fifteen years ago.

The downturn that started last year has been terrible for philanthropy and for the social sector, and its effects will continue for a while. But the bright side is that people have been forced to ask, "How do we do more with less?" Resources are down, but the need has increased, so there are more opportunities to have an impact. That kind of energy leads to innovation—and it's not just in the last year or so. We have seen innovation in philanthropy over the last decade that is partly driven by a desire for impact and partly driven by new people coming into the sector. Many of these new people are "bridgers": they are coming from the business world and from government and are moving into the social sector. It's extraordinary, and it's bringing in more ideas and more energy.

I'm optimistic because no matter how you look at this, over the next few decades there will be a massive amount of money moving into the social sector. My Irish grandfather said, "There are no pockets," and I think that's true. Money has to go somewhere. There will be a huge influx of capital over the next three decades. There is talent coming into the social sector. We have people who are engaged in philanthropy and giving while they are alive. We have more innovation and more ideas.

This is an amazing time. Philanthropy is going to progress further in the next decade than it has in the last two or three decades—maybe in the last four or five decades, which is very exciting. I hope that all of you who are involved in philanthropy will do your best to set the bar very high, because America needs it.

William E. Simon Lecture

2008 **In Defense of Philanthropy As We Know It**
Heather Mac Donald
John M. Olin fellow at the Manhattan Institute and a contributing editor to City Journal

2007 **Philanthropy and Social Entrepreneurship**
David Nasaw
Arthur M. Schlesinger, Jr. professor of history at the Graduate Center of the City University of New York

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